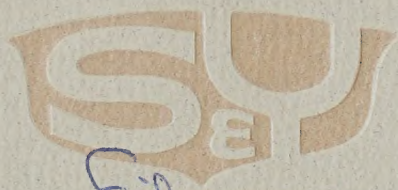


AR49



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SCOTTISH and YORK

1977

Annual Report

Board of Directors

R. D. ABBOT
R. W. BROUGHTON
S. F. CHAPMAN
K. H. DOYLE
W. G. HOLBROOK
ST. CLAIR McCABE
A. D. McEWEN
K. R. THOMSON
J. A. TORY

Officers

R. W. BROUGHTON — *Chairman of the Board and Chief Executive Officer*
W. G. HOLBROOK — *President and Chief Operating Officer*
R. D. ABBOT — *Vice-President and Secretary-Treasurer*
S. F. CHAPMAN — *Vice-President — Finance*
J. A. TORY — *Vice-President*
D. A. BOYD — *Vice-President*
N. W. McDERMOTT — *Asst. Vice-President*

Transfer Agent

MONTREAL TRUST COMPANY

Auditors

THORNE RIDDELL & CO.

Bankers

THE ROYAL BANK OF CANADA

Executive Office

155 UNIVERSITY AVENUE, TORONTO, CANADA

SCOTTISH & YORK HOLDINGS LIMITED

Canada

SCOTTISH & YORK INSURANCE CO. LIMITED
VICTORIA INSURANCE COMPANY OF CANADA
CENTRAL CANADA INSURANCE SERVICE LIMITED
ONTARIO INSURANCE SERVICE

United States

SCOTTISH & YORK, INC.
SCOTTISH & YORK INTERNATIONAL INSURANCE, INC.
LINCOLN INSURANCE COMPANY
GUARANTEE INSURANCE COMPANY
ASSOCIATED TREATY MANAGERS, INC.
INTERNATIONAL MANAGEMENT CORPORATION
LINCOLN MANAGEMENT CORP.
INTERNATIONAL PREMIUM COMPANY

Nassau, Bahamas

VICTORIA INSURANCE COMPANY LIMITED

United Kingdom

OVERSEAS INSURANCE SERVICES

SCOTTISH & YORK HOLDINGS GROUP

To The Shareholders

1977 has proven to be the most successful year to-date in the history of your Company. Consolidated net income for the year was \$6,252,237 or 78.2¢ per common share compared with net income of \$2,489,230 or 31.1¢ per common share in 1976. Gross premiums written rose to \$116,094,454 from \$56,052,394. Underwriting profit increased to \$6,312,380 from \$820,488. Investment income amounted to \$5,050,137, up from \$3,736,682 in 1976.

United States operations continued to expand in 1977 both in terms of premium writings and broader licensing and approvals. Gross premiums written in the U.S. for 1977 amounted to \$48,073,898 compared to \$16,525,977 in 1976. Underwriting profit was up from \$480,240 in 1976 to \$5,232,676 in 1977. Twenty-eight additional State licenses or approvals were obtained in 1977 bringing the total number of States in which the Guarantee Insurance Company is now licensed to thirty-two and in which the Lincoln Insurance Company has obtained approvals to forty-one. We will continue to seek additional licenses and approvals and it is anticipated that several more will be secured during 1978.

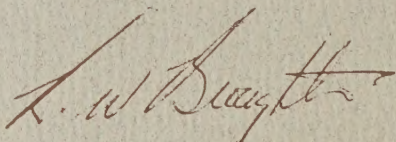
Canadian operations showed continued improvement in 1977. Gross premiums written increased to \$68,020,556 from \$39,526,417 and underwriting profits rose to \$1,079,704 from \$340,248. In the opinion of Management, the Company and its Canadian subsidiaries have complied with the provisions of the Federal Government's Anti Inflation Act. Canadian operations will continue to be subject to the provisions of this Act until the end of 1978. Effective March 1st 1978 the Government of the Province of Quebec entered the automobile insurance field. They have limited their involvement to bodily injury with property damage coverages remaining with the private sector. This will mean a loss of approximately \$950,000 in premium volume to our Companies. However, we expect that this will be more than offset through new product lines and increased penetration in other areas.

In light of the improved earnings in 1977 the Directors of your Company approved two dividend increases during the year, the quarterly dividend paid December 31st 1977 being 3- $\frac{3}{4}$ ¢ per common share compared to 2¢ per common share the previous year.

The outlook for 1978 is encouraging. We anticipate solid growth in premium writings in the United States as we capitalize on the broader licenses and approvals secured in 1976 and 1977. Rate competition which has become evident in Canada in the past few months is not apparent in the U.S. at this time nor do we expect it to become significant, at least during 1978. Despite the intense price competition in Canada and the partial loss of Quebec automobile premiums, we expect to see modest improvement in our Canadian operations in 1978.

The contributions of Management and Staff to the growth and development of the Company is greatly appreciated and, on behalf of the Board of Directors, I would like to express our sincere thanks for a job well done.

Submitted on behalf of the
Board of Directors



R. W. BROUGHTON
Chairman of the Board

SCOTTISH & YORK HOLDINGS LIMITED
and subsidiary companies

Auditors' Report

To the Shareholders of
Scottish & York Holdings Limited

We have examined the consolidated balance sheet of Scottish & York Holdings Limited as at December 31, 1977 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. For those subsidiaries of which we are not the auditors, we have carried out such enquiries and examinations as we considered necessary in order to rely on the reports of the other auditors for purposes of consolidation.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada
March 13, 1978

THORNE RIDDELL & CO.,
Chartered Accountants

SCOTTISH & YORK HOLDINGS LIMITED (Incorporated under the laws of Scotland)

CONSOLIDATED BALANCE SHEET DECEMBER 31, 1977

ASSETS		
	1977	1976
Cash	\$ 2,668,635	\$ 753,737
Marketable securities (note 2)		
Term deposits	22,172,268	24,676,083
Bonds (market value 1977, \$54,535,759; 1976, \$26,524,741)	55,745,866	26,691,460
Stocks (market value 1977, \$7,160,626; 1976, \$4,345,385)	7,824,814	5,362,883
Accrued interest on bonds and term deposits	860,722	723,201
Accounts receivable	20,781,656	5,081,827
Furniture, fixtures and automobiles less accumulated depreciation 1977, \$132,640; 1976, \$105,878	253,726	138,476
Agencies, agreements and contracts, at cost		110,116
Premium paid on acquisition of shares of subsidiary companies, net of amortization of \$69,230 (1976, \$23,328)	1,006,513	542,543
	<u>\$111,314,200</u>	<u>\$64,080,326</u>

Approved by the Board

W. G. HOLBROOK, Director

R. D. ABBOT, Director

LIABILITIES

	1977	1976
Notes payable (note 3)	\$ 4,036,147	\$ 1,893,808
Accounts payable and accrued liabilities	22,359,594	7,399,746
Customers' deposits	26,250	26,250
Provision for outstanding claims	40,059,749	24,329,869
Income and premium taxes payable	4,301,614	2,334,844
Deferred revenue	19,653,637	13,350,424
Interest of minority common shareholders of subsidiary companies	2,008,795	1,269,208
	<u>92,445,786</u>	<u>50,604,149</u>

SHAREHOLDERS' EQUITY

Capital stock		
Authorized		
10,000 First preference shares, par value \$50 each, issuable in series		
12,000,000 Common shares without par value		
Issued		
8,000,000 Common shares	3,701,000	3,701,000
Retained earnings	15,167,414	9,775,177
	<u>18,868,414</u>	<u>13,476,177</u>
	<u>\$111,314,200</u>	<u>\$64,080,326</u>
Contingent liabilities and contractual commitments (note 4)		

SCOTTISH & YORK HOLDINGS LIMITED
and subsidiary companies

CONSOLIDATED STATEMENT OF INCOME
YEAR ENDED DECEMBER 31, 1977

	<u>1977</u>	<u>1976</u>
Gross premiums written and other income	\$121,144,591	\$59,789,076
Underwriting profit.....	6,312,380	820,488
Investment income	5,050,137	3,736,682
	11,362,517	4,557,170
Interest on notes payable	156,874	126,850
Income before undernoted items.....	11,205,643	4,430,320
Income taxes.....	4,179,277	1,772,550
Income before minority interest	7,026,366	2,657,770
Interest of minority common shareholders of subsidiary companies.....	774,129	168,540
Net income	\$ 6,252,237	\$ 2,489,230
Earnings per share	78.2¢	31.1¢

CONSOLIDATED STATEMENT OF RETAINED EARNINGS
YEAR ENDED DECEMBER 31, 1977

	<u>1977</u>	<u>1976</u>
Balance at beginning of year	\$ 9,775,177	\$ 7,565,947
Net income	6,252,237	2,489,230
	16,027,414	10,055,177
Dividends on common shares	860,000	280,000
Balance at end of year	\$ 15,167,414	\$ 9,775,177

SCOTTISH & YORK HOLDINGS LIMITED
and subsidiary companies

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR ENDED DECEMBER 31, 1977

	<u>1977</u>	<u>1976</u>
Resources provided		
Operations (as outlined below)	\$28,338,773	\$19,216,632
Issue of common shares for cash		3,177,741
Decrease in term deposits	2,503,815	
Net change in other assets and liabilities	1,966,771	2,177,711
Proceeds from notes payable	3,334,090	700,005
	<u>\$36,143,449</u>	<u>\$25,272,089</u>
Resources applied		
Purchase of marketable securities, net		
Bonds	\$29,054,406	\$ 7,638,076
Stocks	2,461,931	1,085,511
Notes payable	1,191,751	3,082,000
Increase in term deposits		13,060,026
Purchase of furniture, fixtures and automobiles, net	150,590	72,911
Increase in premium paid on acquisition of shares of subsidiary companies	509,873	
Dividends on common shares	860,000	280,000
Increase in cash	1,914,898	53,565
	<u>\$36,143,449</u>	<u>\$25,272,089</u>
Operations		
Net income	\$ 6,252,237	\$ 2,489,230
Items not involving cash		
Depreciation	35,340	28,128
Amortization of premium paid on acquisition of shares of subsidiary companies	45,902	9,564
Interest of minority common shareholders of subsidiary companies	739,587	176,641
Write off of premium paid on acquisition of subsidiaries		127,531
Increase in deferred revenue	6,303,213	3,093,473
Increase in provision for outstanding claims	15,729,880	8,698,284
Increase in accounts payable and accrued liabilities	14,959,848	5,385,746
Write off of agencies, agreements and contracts	110,116	
Increase in accounts receivable and accrued interest	(15,837,350)	(791,965)
Resources provided from operations	<u>\$28,338,773</u>	<u>\$19,216,632</u>

SCOTTISH & YORK HOLDINGS LIMITED

and subsidiary companies

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 1977

1. ACCOUNTING POLICIES

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles which, as to the subsidiary insurance companies, differ in some respects from statutory accounting practices followed in the preparation of financial statements submitted to regulatory authorities.

(a) Principles of Consolidation

The consolidated financial statements include all the subsidiary companies, which are:

	Percentage ownership
Canadian Group	
Scottish & York Insurance Co. Limited	97.92%
Central Canada Insurance Service Limited	100%
Victoria Insurance Company of Canada	99.1%
U.S. Group	
Scottish & York, Inc.	100%
Lincoln Insurance Company	80%
Lincoln Management Corp.	80%
Associated Treaty Managers, Inc.	80%
Guarantee Insurance Company	80%
International Management Corporation	80%
Scottish & York International Insurance, Inc.	80%
International Premium Company	80%
Bahamas	
Victoria Insurance Company Limited	100%

Under an agreement dated June 27, 1975, among Scottish & York Holdings Limited, International Insurance Holdings Corporation, Scottish & York, Inc. and Scottish & York International Insurance, Inc. relating to the July 1, 1975 acquisition of the 80% interest in the U.S. Group, provision is made whereby additional consideration may be payable depending on the level of future profits of the U.S. Group. The purchase agreement also provides for adjustments in respect of uncollected accounts receivable, undisclosed liabilities and unreflected assets at that date. During 1977 Scottish & York, Inc. realized tax savings attributable to the utilization of the remaining balance of loss carry forwards of the U.S. Group prior to July 1, 1975. In accordance with the terms of the purchase agreement the purchase consideration is increased by an amount equal to the tax reduction relating thereto. As a result of the application of these covenants of the purchase agreement a provision for additional purchase consideration amounting to \$509,873 has been paid or accrued in the accounts.

(b) Translation into Canadian Dollars

The accounts of the subsidiary companies in the United States and the Bahamas have been translated into Canadian dollars on the following basis:

- (i) assets and liabilities of a monetary nature at the rate of exchange prevailing at December 31,
 - (ii) all other assets and liabilities at the rate of exchange prevailing at the date the assets were acquired or the liabilities incurred,
 - (iii) income and expenses at the average rate for the year.
- (c) Marketable Securities
- (i) Term deposits are recorded at cost.
 - (ii) Bonds are recorded at cost or amortized cost.
Interest income is recorded on an accrual basis.
 - (iii) Stocks are recorded at cost.
Dividend income is recorded on a cash received basis.
 - (iv) Gains and losses on disposal of investments are determined on a first in, first out basis.
- (d) Furniture, Fixtures and Automobiles and Accumulated Depreciation
All furniture, fixtures and automobiles are recorded at cost, less accumulated depreciation. Furniture, fixtures and equipment are depreciated over their estimated useful life at varying rates ranging from 12½% straight line basis to 20% reducing balance basis. Automobiles are depreciated over their useful life at the rate of 30% reducing balance basis.
- (e) Premium Paid on Acquisition of Shares of U.S. Subsidiary Companies
The company amortizes such premium over forty years from date of acquisition.
- (f) Deferred Revenue
- (i) Deferred commission income and policy acquisition costs.
Policy acquisition costs, net of reinsurance allowances, are deferred and amortized over the terms of the related policies. For the years 1977 and 1976 deferred commission income exceeded deferred acquisition costs. Accordingly, the net credit balance is included in deferred revenue.
 - (ii) Deferred premium income.
Premium income is deferred until it is earned. The basis for taking premiums into income is in accord with policies prescribed by the regulating organizations under which the companies operate.
- (g) Provision for Outstanding Claims
The liabilities for losses and claims and related adjustment expenses are determined using case basis evaluations plus a provision for unreported claims and represent estimates of the ultimate net cost of all losses and claims incurred through December 31, 1977. Since the provisions are necessarily based on estimates of future trends in claim severity and frequency and other factors, which could vary as the losses are settled, the ultimate liability may be more or less than the estimated amounts. These liabilities have been stated net of reinsurance recoverable from other companies. Although it is not possible to measure the degree of variability inherent in such estimates, management believes that the liabilities for losses and related adjustment expenses are adequate. The estimates are continually reviewed and, as adjustments to these liabilities become necessary, they are reflected in current operations.
- (h) Recognition of Income
A subsidiary company, Associated Treaty Managers, Inc., manages a number of reinsurance arrangements for which it receives management fees based upon earned premiums. The fee income is recognized simultaneously with the recognition of earned premiums by the reinsurers.

2. MARKETABLE SECURITIES

Marketable securities having a cost of approximately U.S. \$9,800,000 at December 31, 1977 were deposited to secure liabilities from participation in reinsurance pools and reinsurance ceded contracts.

3. NOTES PAYABLE

	<u>Total</u>	<u>Due within one year</u>
Note payable bearing interest at the rate of U.S. prime plus 1½% (\$3,500,000 U.S.)	\$3,830,400	\$547,200
Demand note payable interest at the rate of U.S. prime plus 1% (\$188,000 U.S.)	<u>205,747</u>	<u>205,747</u>
	<u>\$4,036,147</u>	<u>\$752,947</u>

Principal due in each of the next five years:

1978	\$752,947	U.S. \$688,000
1979	273,600	250,000
1980	547,200	500,000
1981	820,800	750,000
1982	820,800	750,000

4. CONTINGENT LIABILITIES AND CONTRACTUAL COMMITMENTS

- (a) A wholly owned subsidiary company Victoria Insurance Company Limited, has been assessed Federal income taxes relating to the years 1968, 1969, and 1970 amounting to approximately \$1,000,000 including interest to November 30, 1973. A Notice of Objection was filed with respect to these assessments in 1974 and Revenue Canada, Taxation reconfirmed the assessments on February 6, 1975.

The company received a favourable judgement on an appeal to the Tax Review Board on September 7, 1977 but has received notification from Revenue Canada, Taxation of its intention to appeal the decision to the Federal Court of Canada. No date for a hearing of this second appeal has been set.

The company has deposited its share investment in subsidiary companies Scottish & York Insurance Co. Limited and Victoria Insurance Company of Canada with The Royal Bank of Canada to be held as security until the outcome of this appeal is known.

- (b) The company leases office space for a term expiring in 1984 with an option to extend this to 1994. The annual rental is approximately \$105,000.

5. ANTI-INFLATION LEGISLATION

The company and its Canadian subsidiaries are subject to the provisions of the Federal Government's Anti-Inflation Act which became effective on October 14, 1975. This Act imposes restrictions on prices, profit margins, compensation to employees and payment of dividends by the parent company.

In the opinion of management, the company and its Canadian subsidiaries have complied with the provision of the Act.

6. OTHER STATUTORY INFORMATION

	<u>1977</u>	<u>1976</u>
Direct remuneration of directors and senior officers (as defined by The Business Corporations Act)	\$266,500	\$254,158
Depreciation.	\$ 35,340	\$ 28,128
Amortization	\$ 45,902	\$ 9,564

SCOTTISH & YORK HOLDINGS GROUP

Five Year Performance Record

YEAR	GROSS PREMIUMS WRITTEN	NET PREMIUMS WRITTEN	DEFERRED REVENUE	INCOME BEFORE TAXES AND MINORITY INTEREST	INCOME TAXES	NET INCOME	EARNINGS PER SHARE	DIVIDENDS PAID PER SHARE
1977	116,094,454	58,638,786	19,653,637	11,205,643	4,179,277	6,252,237	78.2¢	10.75¢
1976	56,052,394	41,540,610	13,350,424	4,430,320	1,772,550	2,489,230	31.1¢	3.5¢
1975	31,676,100	24,373,390	10,256,951	1,244,773	377,293	910,286	15.2¢	—
1974	19,975,895	13,812,615	4,837,483	1,256,719	429,534	827,185	13.8¢	13.5¢
1973	23,223,028	16,151,894	5,002,818	1,926,717	536,558	1,390,159	23.2¢	18¢

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SCOTTISH
&
YORK

—
INTERIM
REPORT

JUNE 30, 1977
—

SCOTTISH & YORK HOLDINGS LIMITED
and Subsidiary Companies
CONSOLIDATED STATEMENT OF INCOME

TO THE SHAREHOLDERS

Net income for the six month period ended June 30, 1977 was \$2,312,768 or 29¢ per common share compared to \$1,001,773 or 13¢ per share for the same period last year. Net income for the first half of 1977 benefited by \$444,000 or 5½¢ per common share from the carry forward of prior years' losses of United States Subsidiaries.

United States operations made a significant contribution to the excellent progress made during the first half of 1977. The Canadian companies, while subject to the restraining influence of the Anti-Inflation Act, showed continued improvement for the same period. The outlook for the balance of the year on both Canadian and United States operations continues to be favourable.

The Directors have determined that the Company's results justify an increase in the quarterly dividend rate from 2¢ to 3¢ per share and accordingly have declared a dividend of 3¢ per common share for the third quarter of 1977 payable September 30, 1977 to shareholders of record on September 9, 1977.

R. W. BROUGHTON,
Chairman of the Board and
Chief Executive Officer

August 19, 1977

	Six Months Ended	
	June 30, 1977	June 30, 1976
Gross Premiums Written and Other Income	<u>\$47,414,230</u>	<u>\$25,833,184</u>
Underwriting Profit	1,711,322	218,180
Investment Income	<u>2,198,101</u>	<u>1,581,633</u>
	3,909,423	1,799,813
Interest on Notes Payable	<u>29,925</u>	<u>68,671</u>
	3,879,498	1,731,142
Income Taxes	<u>1,188,343</u>	<u>656,341</u>
	2,691,155	1,074,801
Interest of Minority Common Shareholders of Subsidiary Companies	<u>378,387</u>	<u>73,028</u>
Net Income	<u>\$2,312,768</u>	<u>\$1,001,773</u>
Net Income per Share	29¢	13¢

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Six Months Ended	
	June 30, 1977	June 30, 1976
Resources Provided		
Operations:		
Net Income for the Six Months	\$2,312,768	\$1,001,773
Add Items not Involving a Current Outlay of Funds		
Depreciation	17,000	17,000
Interest of Minority Common Shareholders of Subsidiary Companies	<u>378,387</u>	<u>73,028</u>
	2,708,155	1,091,801
Proceeds from Rights Offering	—	3,177,741
Increase in Accounts Payable	4,392,417	1,130,108
Increase in Provision for Outstanding Claims	5,614,065	2,671,872
Increase in Deferred Revenue	5,827,742	4,018,580
Decrease in Cash	—	1,690,156
Net Change in Other Assets and Liabilities	<u>—</u>	<u>494,055</u>
	<u>\$18,542,379</u>	<u>\$14,274,313</u>
Resources Applied		
Increase in Cash	\$2,185,774	\$ —
Purchase of Marketable Securities, Net	9,722,444	7,697,451
Increase in Accounts Receivable	4,982,188	3,709,129
Decrease in Notes Payable	675,808	2,867,733
Dividends on Common Shares	320,000	—
Net Change in Other Assets and Liabilities	<u>656,165</u>	<u>—</u>
	<u>\$18,542,379</u>	<u>\$14,274,313</u>